



# Understanding the Financial Planning Process

## Chapter 1

# Learning Goals

**LG1**

Identify the benefits of using personal financial planning techniques to manage your finances.

**LG2**

Describe the personal financial planning process and define your goals.

**LG3**

Explain the life cycle of financial plans, their role in achieving your financial goals, how to deal with special planning concerns, and the use of professional financial planners.

**LG4**

Examine the economic environment's influence on personal financial planning.

**LG5**

Evaluate the impact of age, education, and geographic location on personal income.

**LG6**

Understand the importance of career choices and their relationship to personal financial planning.



# How Will this Affect Me

- The heart of financial planning is making sure your values line up with how you spend and save.
- An informed financial plan should reflect uncertainties and more.
- This chapter overviews the financial planning process and explains its context.



# Financial Facts or Fantasies?

- ▶ Your income level depends on your age, education, and career choice
- ▶ Over the long run, gaining only an extra percent or two on an investment makes little difference in the amount of earnings generated
- ▶ Personal financial planning involves translating personal financial goals into specific plans and arrangements that put these plans into action.
- ▶ A savings account is an example of a tangible asset because it represents something on deposit at a bank or other financial institution.
- ▶ An improved standard of living is one of the payoffs of sound personal financial planning.



# Personal Financial Planning

- A systematic process that considers important elements of an individual's financial affairs in order to fulfill financial goals.

# Six-Steps Financial Planning Process

1. Define financial goals.

2. Develop financial plans and strategies to achieve goals.

3. Implement financial plans and strategies.

4. Periodically develop and implement budgets to monitor and control progress toward goals.

5. Use financial statements to evaluate results of plans and budgets, taking corrective action as required.

6. Redefine goals and revise plans and strategies as personal circumstances change.



# Rewards of Sound Financial Planning

- Flexibility
- Improved Standard of Living
- Spend money more wisely
- Accumulate Wealth

# Organizational Planning Model





# The Average American, Financially Speaking

	<b>Income and Assets</b>	
<b>What Do We Earn? (<i>median</i>)</b>		
All families	\$	46,700
<b>What Are We Worth? (<i>median</i>)</b>		
All families		81,200
<b>Home Ownership (<i>median</i>)</b>		
Value of primary residence		170,000
Mortgage on primary residence		115,000
<b>How Much Savings Do We Have? (<i>median</i>)</b>		80,000
Pooled investment funds (excluding money market)		27,000
Individual stocks		94,500
Bonds		20,100
Bank accounts/CDs		
Retirement accounts		59,000



# Financial Goals

- Results that an individual wants to attain, such as buying a home, building a college fund, or achieving financial independence.
- Examples:
  - Controlling living expenses
  - Retirement planning
  - College Education for kids



# Financial Goals Myths

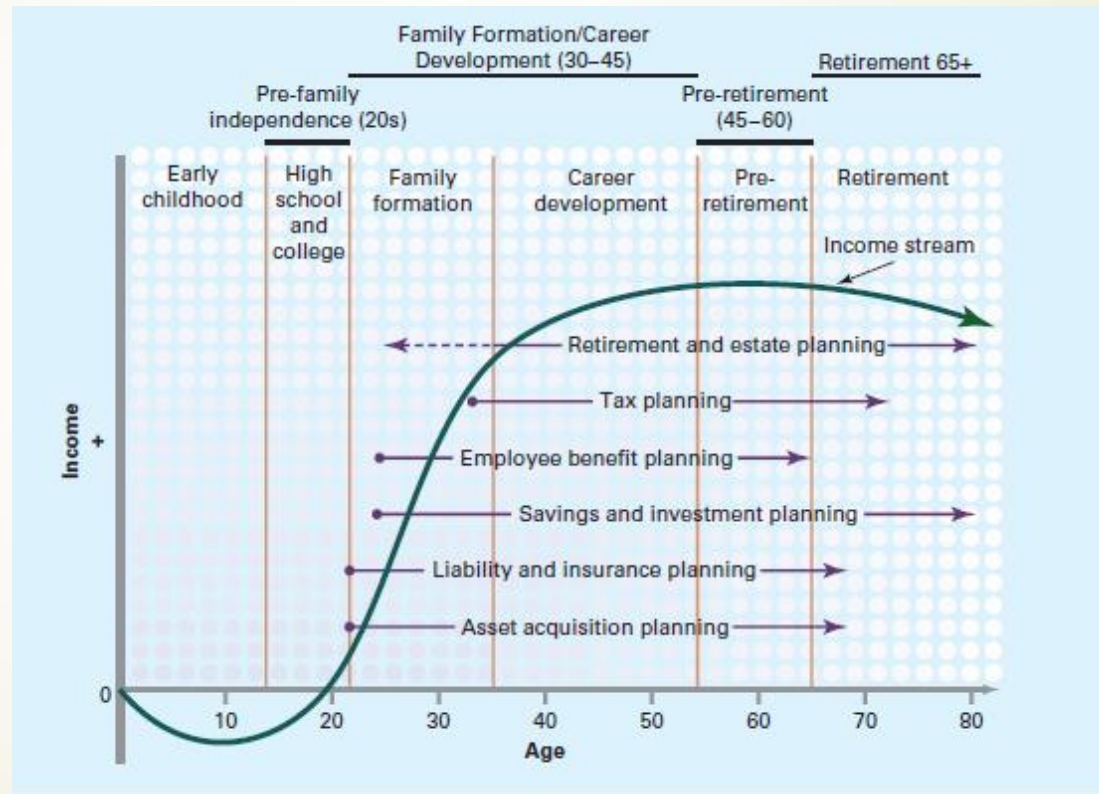
- ▶ A Emergency Fund that lasts three months should be adequate
- ▶ I will be able to retire at 65 and should have plenty to live on in retirement
- ▶ Saving a few thousand dollars a year should provide enough to fund my child's education.
- ▶ I am relying on the rule of thumb that I will need only 70 Percent of my pre-retirement income to manage nicely in retirement.

# Putting Target Dates on Financial Goals

- Long-term  
6 years or more
- Intermediate-term  
the next 2-5 years
- Short-term  
in the next year



# The Personal Financial Planning Life Cycle



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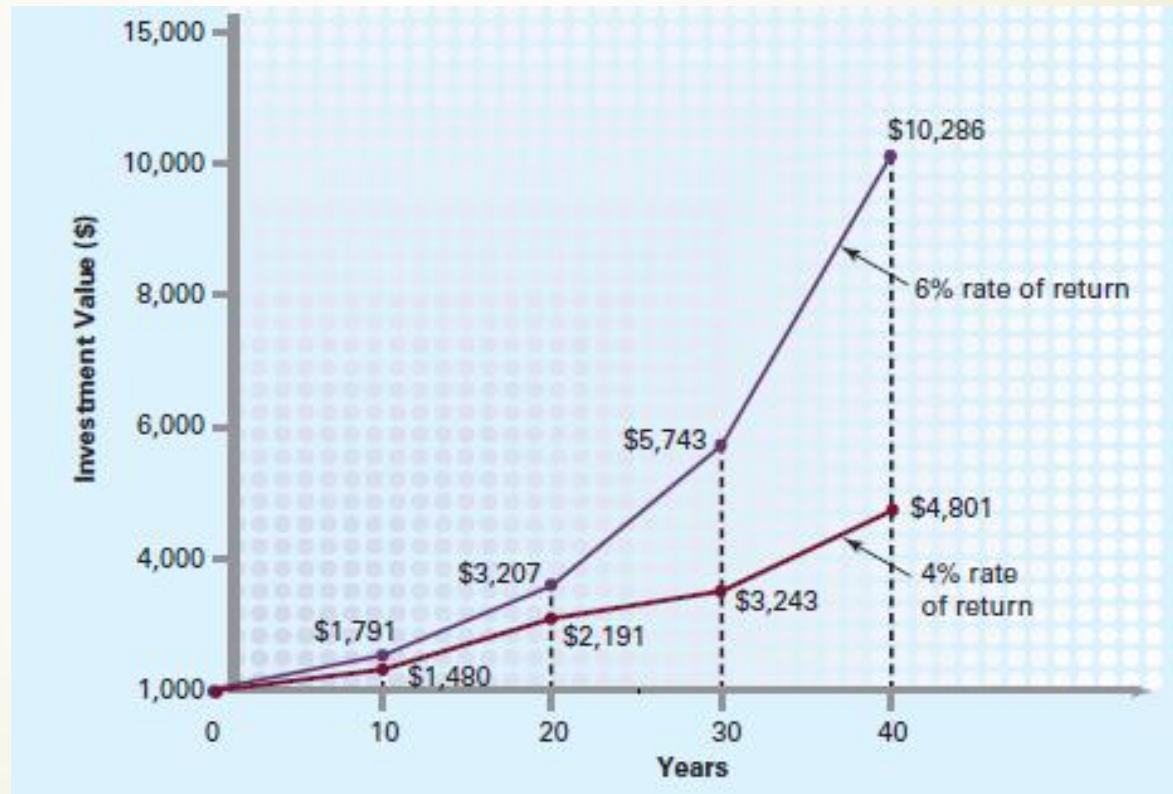


# Retirement Planning

Example: The sooner you start an IRA, the better

If you start investing for retirement at age 40 and put only \$2,000 a year in an IRA earning 5 percent for 25 years, you will have \$95,454 at age 65. However, if you start the same retirement plan 10 years earlier at age 30, **you will have \$180,641** at age 65!

# How a \$1,000 Investment Grows over Time



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# Special Planning Concerns

- Managing Two Incomes
- Managing Employee Benefits
- Managing Finances in Tough Economic Times
- Adapting to Other Major Life Changes





# Two Income Family Facts or Fantasies

- ▶ Two-income couples account for the majority of U.S. households
- ▶ Often a second income does not add as much as expected to the bottom line
- ▶ Two-income couples should have two checking accounts to keep earnings separate
- ▶ Second income is used only for investments
- ▶ Two-income couples have more stress and spend less time with family



# Professional Financial Planner

- An individual or firm that helps clients establish financial goals and develop and implement financial plans to achieve those goals.



# Using Professional Financial Planners

- Commission-based planners earn commission on selling financial products such as insurance or annuities.
- Fee-only planners charge fees based on complexity of prepared plans and time
- Hybrid approach involves both charging fees and collecting commissions.

# Financial Planners Designations

## Exhibit 1.9

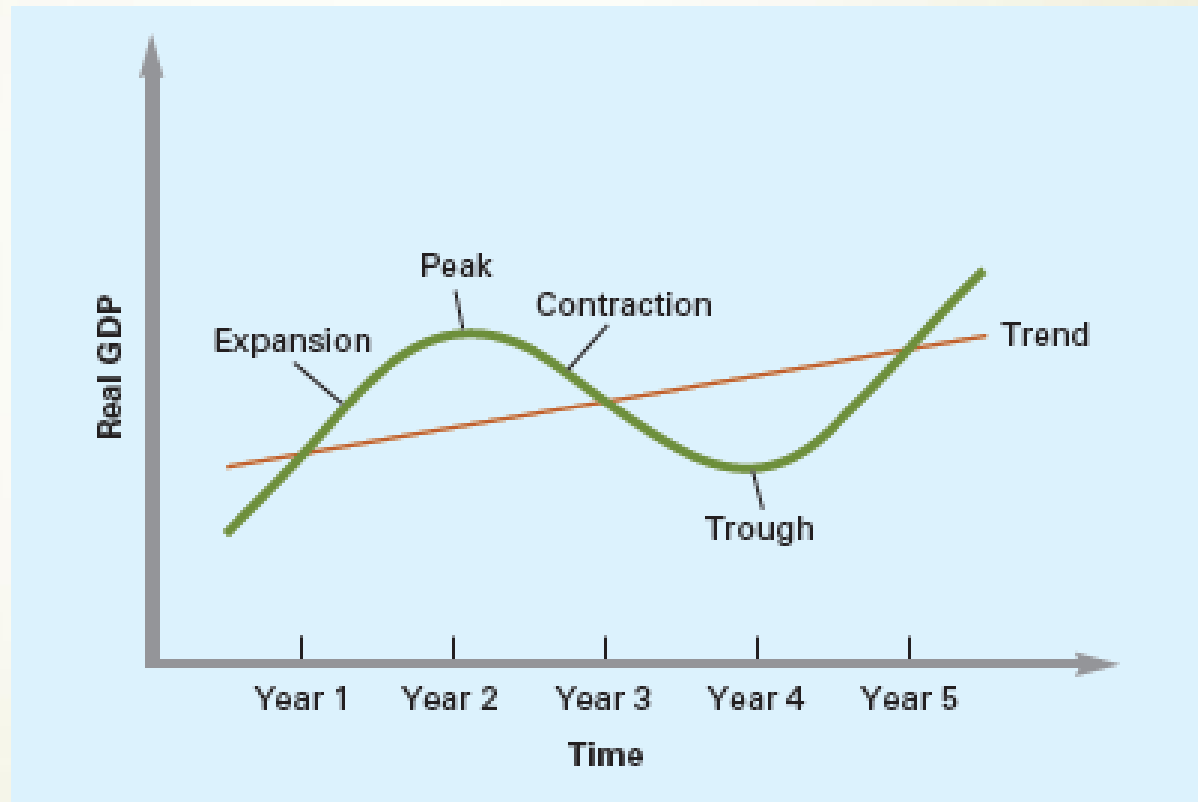
Credential	Description	Internet Address
Chartered Financial Analyst (CFA)	Focuses primarily on securities analysis not financial planning	<a href="http://www.cfainstitute.org">http://www.cfainstitute.org</a>
Certified Financial Planner® (CFP®)	Requires a comprehensive education in financial planning	<a href="http://www.cfp.net">http://www.cfp.net</a>
Chartered Financial Consultant (ChFC)	Financial planning designation for insurance agents	<a href="http://www.theamericancollege.edu/">http://www.theamericancollege.edu/</a>
Certified Trust & Financial Advisor (CTFA)	Estate planning and trusts expertise, found mostly in the banking industry	<a href="http://aba.com/ICB/CTFA.htm">http://aba.com/ICB/CTFA.htm</a>
Personal Financial Specialist (PFS)	Comprehensive planning credential only for CPAs	<a href="http://www.pfp.aicpa.org">http://www.pfp.aicpa.org</a>
Chartered Life Underwriter (CLU)	Insurance agent designation, often accompanied by the ChFC credential	<a href="http://www.theamericancollege.edu">http://www.theamericancollege.edu</a>
Certified Investment Management Analyst	Consulting designation for professional investment managers	<a href="http://www.imca.org/">http://www.imca.org/</a>
Registered Financial Associate (RFA)	Designation granted only to recent graduates of an approved academic curriculum in financial services	<a href="http://www.iaffc.org">http://www.iaffc.org</a>



# The Planning Environment

- ▶ Financial planning takes place in a dynamic economic environment created by the actions of
  - ▶ Government – through regulation, expenditures and tax policies
  - ▶ Business – provide consumers with goods and services
  - ▶ Consumers – their choices determines the kinds of goods and services that businesses will provide

# Business Cycle – Four stages: Expansion, Peak, Contraction, Trough





# What Determines your Personal Income

- ▶ Your Education
- ▶ Where you Live
- ▶ Your Career
  - ▶ Examples of Average Annual Salary
  - ▶ Accountants -- \$73,760
  - ▶ Computer Programmer - \$82,690
  - ▶ Lawyer - \$133,470
  - ▶ Financial analyst - \$92,250
  - ▶ Teacher, elementary - \$56,830

# How Age and Education Affect Annual Income

ANNUAL INCOME (HEAD OF HOUSEHOLD)	
Age	Median Income (\$)*
Less than 35	35,300
35–44	60,900
45–54	60,900
55–64	55,100
65–74	45,900
75 or older	28,500
Education	Median Income (\$)***
No high school diploma	20,150
High school diploma	29,770
Bachelor's degree	50,280
Master's degree	61,040
Professional degree	97,200
Dr. degree	82,880

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